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CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 224

JAMES F. WATERS, INC., A CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court of the United States (R. 39–51) are not reported. The opinion of the Circuit Court of Appeals (R. 286–293) is reported at 160 F. 2d 596.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 19, 1947 (R. 293). Rehearing was denied on April 25, 1947 (R. 294). The petition for a writ of certiorari was filed on July 23, 1947. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial

Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the Congress can make final a decision of the Tax Court insofar as it relates to a question determined solely by reason of Section 721 of the Internal Revenue Code, as amended, which provided special administrative relief from the provisions of the excess profits tax.

2. Whether the net proceeds of certain insurance policies on the life of an individual, which were received by the taxpayer corporation by virtue of an assignment for valuable consideration, are includible in its gross ncome under Section 22 of the Internal Revenue Code, and whether, if so, Section 22, as so applied, is constitutional.

STATUTES AND REGULATIONS INVOLVED

The material provisions of the statutes and Treasury Regulations are set forth in the Appendix, *infra,* pp. 10–26.

STATEMENT

The facts, as stipulated and as found by the Tax Court (R. 40–49), may be summarized as follows:

James F. Waters, an individual, was the president and the principal stockholder of the taxpayer, a California corporation, from the date of its organization until his death on May 10, 1941,

and of the James F. Waters Securities Corporation, a California corporation (hereinafter called Securities), from the date of its organization until it was merged into the taxpayer on or about October 31, 1938 (R. 40).

James F. Waters procured certain policies of insurance upon his life at various dates between 1927 and 1930 (R. 40–41). He thereafter procured certain other policies of life insurance at various times (R. 41–42).

Waters transferred and assigned the insurance policies to Securities for the sum of $6,222.32, being the aggregate cash surrender value of the policies after payment of all premiums becoming due in 1935, minus the aggregate amount of the unpaid premiums due on all of the policies during 1935 and after April 26, 1935 (R. 41, 42).

On or about October 31, 1938, Securities merged with the taxpayer, and there were then transferred to taxpayer, by operation of law, all of the insurance policies heretofore described. Neither the taxpayer nor Securities recognized any gain or loss upon the transfer of such insurance policies to taxpayer. (R. 43.)

The taxpayer failed to pay premiums on the policies commencing in 1939 and the policies, in accordance with their respective provisions, became converted into various types of paid-up or term insurance (R. 46–47).

James F. Waters died on May 10, 1941, and the taxpayer received a total of $141,693.77 under

the various policies held by it which were still in force (R. 44–45).

The Tax Court held that the net insurance proceeds were includible in the taxpayer's gross income under the specific provisions of Section 22 (b) (2) (A) (R. 49–50), and that such proceeds did not constitute abnormal income attributable to prior years under Section 721 of the Code (R. 51). The court below sustained the holding of the Tax Court that the net insurance policy proceeds were includible in gross income and further held that it was without jurisdiction to review the Tax Court's holding with respect to the Section 721 issue because of the express prohibition against such review in Section 732 (c) of the Code (R. 288–293).

ARGUMENT

1. Section 732 (c) of the Internal Revenue Code (Appendix, *infra*, p. 16), provides that if in the determination of tax liability under the excess profits tax law, the determination of any question is necessary solely by reason of Section 721 (Appendix, *infra*, p. 12), the Commissioner's determination of such question shall not be reviewed or redetermined by any court except the Tax Court. The court below sustained the Commissioner's contention that it was without jurisdiction to review the decision of the Tax Court that the proceeds of the insurance policies here involved did not constitute abnormal income at-

tributable to prior taxable years under Section 721 (b) and (c) of the Code, and under the pertinent Treasury Regulations (Appendix, *infra*, pp. 18–24.

The now-repealed excess profits tax was imposed by sections of the Internal Revenue Code commencing with Section 710. Section 721 is a relief provision granting special relief from taxation where abnormalities in income occur. *Pohatcong Hosiery Mills* v. *Commissoner*, (C. C. A. 3rd), decided May 23, 1947 (1947 P-H., par. 72470); *Southwestern Oil & Gas Co.* v. *Commissioner*, 6 T. C. 1124; *Premier Products Co.* v. *Commissioner*, 2 T. C. 445; H. Rep. No. 146, 77th Cong., 1st Sess., p. 9 (1941–1 Cum. Bull. 550, 556), 7A Mertens, *Law of Federal Income Taxation*, Sec. 42.49. Like Section 722, it is a special relief provision "reminiscent of sovereign gracious clemency". *Stimson Mill Co.* v. *Commissioner* (C. C. A. 9th), decided July 21, 1947 (1947 C. C. H., par. 5914). Such relief is allowed by Congress only as a matter of grace and it may be conditioned, limited or denied entirely. *Helvering* v. *Ind. Life Ins. Co.*, 292 U. S. 371; *New Colonial Co.* v. *Helvering*, 292 U. S. 435; *Brushaber* v. *Union Pac. R. R.*, 240 U. S. 1. Congress may eliminate or withhold entirely the appellate jurisdiction of the inferior federal courts and even of the Supreme Court itself. *Lockerty* v. *Phillips*, 319 U. S. 182; *Ex parte McCardle*, 7 Wall. 506, 512–514; cf. *Missouri* v. *Missouri Pac. Ry. Co.*, 292 U. S. 13. This

Congress did in Section 732 (c) of the Code. That Section provides that there shall be no review of a determination by the Tax Court of a question under Section 721 by any other court or agency. The review which the taxpayer sought below was intentionally prohibited by Congress in clear and unmistakable terms under Section 732 (c). H. Rep. No. 146, 77th Cong., 1st Sess., pp. 14–15 (1941–1 Cum. Bull. 550, 560); S. Rep. No. 75, 77th Cong., 1st Sess., pp. 15–16 (1941–1 Cum. Bull. 564).

Congress was acting well within the scope of its recognized power and authority when it so limited review of the relief afforded by Section 721, and the court below correctly decided that there was no violation of Article III of the Constitution as urged by the taxpayer (Pet. 7–9), and that it was without jurisdiction to review the Section 721 issue.[1] That there is no right to judicial review of an administrative determination under a relief statute of the type involved here was settled by this Court in several opinions interpreting the First World War excess profits tax law even though Congress did not, in that statute, expressly limit review to the Board of

[1] The decision of the Tax Court that the insurance policy proceeds here involved did not constitute abnormal income attributable to other years under Section 721 (b) and (c) is correct. The Tax Court has consistently so held in cases presenting a similar situation. *Premier Products Co.* v. *Commissioner*, *supra*; *E. T. Slider, Inc.* v. *Commissioner*, 5 T. C. 263.

Tax Appeals. *Welch* v. *Obispo Oil Co.*, 301 U. S. 190; *Heiner* v. *Diamond Alkali Co.*, 288 U. S. 502; *Williamsport Co.* v. *United States*, 277 U. S. 551. The language quoted by the taxpayer from the opinion of this Court in the *Diamond Alkali* case (Br. 15–16) was directed not to the question of the power of Congress to limit judicial review but rather, at most, to the question of whether Congress had, in fact, done so.

2. The Tax Court and the court below have correctly decided that the proceeds of the life insurance policies here involved constitute taxable income in the year of receipt under Section 22 of the Internal Revenue Code (Appendix, *infra*, pp. 10–11) and the applicable Treasury Regulations. Sec. 19.22 (b) (2) (A)–3, Treasury Regulations 103 (Appendix, *infra*, pp. 24–26). The case falls within the provision contained in Section 22 (b) (2) (A) of the Code, the effect of which is to provide that, in the case of a transfer of life insurance policies for a valuable consideration, the proceeds of the policies received by the transferee upon the death of the insured are exempt only to the extent of the consideration paid for the policies upon the transfer and the premiums subsequently paid. Here, the insured transferred the policies for a valuable consideration to Securities, and it would seem clear that if Securities had collected upon the policies it would have received taxable income. When the taxpayer acquired the policies

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from Securities in the tax-free merger, it stepped into the shoes of Securities, and the proceeds of the policies are taxable to it to the same extent that they would have been taxable to Securities. The last sentence of Section 22 (b) (2) (A), stressed by the taxpayer (Br. 39–41), is intended to exempt from taxation the proceeds of insurance policies, which are transferred by one corporation to another in a tax-free reorganization only where the proceeds would have been exempt if received by the transferor. See S. Rep. No. 1631, 77th Cong., 2d Sess., p. 69 (1942–2 Cum. Bull. 504, 558), wherein it is stated that "where a corporation transfers an insurance policy to a successor corporation in a tax-free reorganization, the proceeds received under the policy will be exempt from taxation when received by the transferee if they would have been exempt if received by the transferor". Congress was undoubtedly acting within the scope of its power and authority in thus limiting the exemption afforded to taxpayers by Section 22 (b) (1) so as to subject life insurance proceeds to taxation under Section 22 in circumstances such as are presented here. *Kaufman* v. *United States,* 131 F. 2d 854 (C. C. A. 4th); *Allis* v. *La Budde,* 128 F. 2d 838 (C. C. A. 7th); 1 Mertens, *Law of Federal Income Taxation,* Secs. 6.27, 6.32. Such proceeds have been included in gross income and taxed in a number of cases without discussion of the constitutional question. *King Plow Co.* v. *Commissioner,* 110

F. 2d 649 (C. C. A. 5th); *E. T. Slider, Inc.* v. *Commissioner,* 5 T. C. 263; *Premier Products Co.* v. *Commissioner, supra; Stroud & Co.* v. *Commissioner,* 45 B. T. A. 862. The insurance proceeds received by this taxpayer were not indemnification for loss of a capital asset but were in the nature of income, a profit or return on an investment, or an indemnification for the possible loss of future earnings or profits. Magill, *Taxable Income,* p. 383; *cf. Golden* v. *Commissioner,* 113 F. 2d 590, 593 (C. C. A. 3rd); *Cummings* v. *Commissioner,* 73 F. 2d 2d 477, 480 (C. C. A. 1st).

The Tax Court (R. 49–51) and the court below (R. 287–293) properly disposed of the many other contentions raised by the taxpayer in its petition (Pet. 7–13) and argued in its brief (Br. 11–51).

CONCLUSION

The decision below is correct in all respects. No novel principle is involved nor is there a conflict of decisions. The case does not call for further review and it is respectfully submitted that the petition should be denied.

PHILIP B. PERLMAN,
Solicitor General.
THERON L. CAUDLE,
Assistant Attorney General.
SEWALL KEY,
LEE A. JACKSON,
AUSTIN HOYT,
Special Assistants to the Attorney General.

AUGUST, 1947.

APPENDIX

Internal Revenue Code:

CHAPTER 1—INCOME TAX

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) *Exclusions from gross income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(1) *Life insurance.*—Amounts received under a life insurance contract paid by reason of the death of the insured, whether in a single sum or otherwise (but if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in the gross income);

(2) [as amended by Sec. 110 (a) of the [Revenue Act of 1942, c. 619, 56 Stat. 798] *Annuities, etc.* * * * In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insur-

ance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be exempt from taxation under paragraph (1) or this paragraph. The preceding sentence shall not apply in the case of such a transfer if such contract or interest therein has a basis for determining gain or loss in the hands of a transferee determined in whole or in part by reference to such basis of such contract or interest therein in the hands of the transferor;[2]

* * * * *

(26 U. S. C. 1940 ed., Sec. 22.)

CHAPTER 2—ADDITIONAL INCOME TAXES

Subchapter E—Excess Profits Tax

[As added by Section 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974, which provided that the new subchapter may be cited as the "Excess Profits Tax Act of 1940"]

SEC. 710. IMPOSITION OF TAX.

(a) *Imposition.*—There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1939, on the adjusted excess profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax as follows:

* * * * *

(26 U. S. C. 1940 ed., Sec. 710.)

[2] The last sentence quoted, which was added by Section 110 (a) of the Revenue Act of 1942, by Section 110 (b) thereof was made applicable with respect to taxable years beginning after December 31, 1940.

SEC. 711. EXCESS PROFITS NET INCOME.

(a) *Taxable years beginning after December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13 (a) (2), for such year except that the following adjustments shall be made:

* * * * *

(26 U. S. C. 1940 ed., Sec. 711.)

SEC. 721. ABNORMALITIES IN INCOME IN TAXABLE PERIOD.

(a) [as amended by Sec. 5 of the Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17] *Definitions.*—For the purposes of this section—

(1) *Abnormal income.*—The term "abnormal income" means income of any class includible in the gross income of the taxpayer for any taxable year under this subchapter if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess of 125 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence.

(2) *Separate classes of income.*—Each of the following subparagraphs shall be held to describe a separate class of income:

(A) Income arising out of a claim, award, judgment, or decree, or interest on any of the foregoing; or

(B) Income constituting an amount payable under a contract the performance of which required more than 12 months;[3] or

(C) Income resulting from exploration, discovery prospecting, research, or development of tangible property, patents, formulae, or processes, or any combination of the foregoing, extending over a period of more than 12 months; or

(D) Income includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's accounting period or method of accounting; or

(E) In the case of a lessor of real property, income included in gross income for the taxable year by reason of the termination of the lease; or

(F) Income consisting of dividends on stock of foreign corporations, except foreign personal holding companies.

All the income which is classifiable in more than one of such subparagraphs shall be classified under the one which the taxpayer irrevocably elects. The classification of income of any class not described in subparagraphs (A) to (F), inclusive, shall be subject to regulations prescribed by the

[3] Section 222 (f) of the Revenue Act of 1942 made Section 721 (a) (2) (B) inapplicable to taxable years beginning after December 31, 1941. Section 222 (d) of that Act added Section 736 to the Internal Revenue Code to provide relief for taxpayers with income from long-term contracts, which new provision, by Section 222 (e) of the Act, was made applicable to taxable years beginning after December 31, 1941, unless the taxpayer elected to have it apply to all taxable years beginning after December 31, 1939.

Commissioner with the approval of the Secretary.

(3) *Net abnormal income.*—The term "net abnormal income" means the amount of the abnormal income less, under regulations prescribed by the Commissioner with the approval of the Secretary, (A) 125 per centum of the average amount of the gross income of the same class determined under paragraph (1), and (B) an amount which bears the same ratio to the amount of any direct costs or expenses, deductible in determining the normal-tax net income of the taxable year, through the expenditure of which such abnormal income was in whole or in part derived as the excess of the amount of such abnormal income over 125 per centum of such average amount bears to the amount of such abnormal income.

(b) [as amended by Sec. 5 of the Excess Profits Tax Amendments of 1941] *Amount attributable to other years.*—The amount of the net abnormal income that is attributable to any previous or future taxable year or years shall be determined under regulations prescribed by the Commissioner with the approval of the Secretary. In the case of amounts otherwise attributable to future taxable years, if the taxpayer either transfers substantially all its properties or distributes any property in complete liquidation, then there shall be attributable to the first taxable year in which such transfer or distribution occurs (or if such year is previous to the taxable year in which the abnormal income is includible in gross income, to such latter taxable year) all amounts so attributable to future

taxable years not included in the gross income of a previous year.[4]

(c) [as amended by Sec. 221 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Computation of tax for current taxable year.*—The tax under this subchapter for the taxable year, in which the whole of such abnormal income would without regard to this section be includible, shall not exceed the sum of:

(1) The tax under this subchapter for such taxable year computed without the inclusion in gross income of the portion of the net abnormal income which is attributable to any other taxable year, and

(2) The aggregate of the increase in the tax under this subchapter for the taxable year (computed under paragraph (1)) and for each previous taxable year which would have resulted if, for each previous taxable year to which any portion of such net abnormal income is attributable, an amount equal to such portion had been included in the gross income for such previous taxable year.

(d) [as amended by Sec. 221 (a) of the Revenue Act of 1942] *Computation of tax for future taxable year.*—The amount of the net abnormal income attributable to any future taxable year shall, for the purpose of this subchapter, be included in the gross income for such taxable year.

* * * * *

[4] By Section 17 of the Excess Profits Tax Amendments of 1941, the amendments made by that act of subsections (a) and (b) of Section 721 were made effective as of the date of enactment of the Excess Profits Tax Act of 1940. (See, however, the preceding footnote (No. 2) with respect to Section 721 (a) (2) (B).)

(e) [as amended by Sec. 221 (a) of the Revenue Act of 1942] *Application of section.*—This section shall be applied only for the purpose of computing the tax under this subchapter as provided in subsections (c) and (d), and shall have no effect upon the computation of base period net income. * * *

* * * * *

(f) [as amended by Sec. 221 (a) of the Revenue Act of 1942] *Abnormal income from exploration, etc.*[5]— * * *

* * * * *

(26 U. S. C. 1940 ed., Sec. 721.)

SEC. 732. REVIEW OF ABNORMALITIES BY BOARD OF TAX APPEALS.[6]

(a) [as amended by Sec. 9 of the Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17] *Petition to the Board.*—If a claim for refund of tax under this subchapter for any taxable year is disallowed in whole or in part by the Commissioner, and the disallowance relates to the application of section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722, relating to abnormalities, the Commissioner shall send notice of such disallowance to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Sunday or a legal holiday in the District

[5] By Section 221 (b) of the Revenue Act of 1942, the amendments made by Section 221 (a) of that Act of subsections (c), (d), (e), and (f) of Section 721 were made applicable with respect to taxable years beginning after December 31, 1939.

[6] Name changed to Tax Court by Section 504 of the Revenue Act of 1942.

of Columbia as the ninetieth day) [1] the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the tax under this subchapter. If such petition is so filed, such notice of disallowance shall be deemed to be a notice of deficiency for all purposes relating to the assessment and collection of taxes or the refund or credit of overpayments.

(b) [as amended by Sec. 9 of the Excess Profits Tax Amendments of 1941] *Deficiency found by Board in case of claim.*—If the Board finds that there is no overpayment of tax in respect of any taxable year in respect of which the Commissioner has disallowed, in whole or in part, a claim for refund described in subsection (a) and the Board further finds that there is a deficiency for such year, the Board shall have jurisdiction to determine the amount of such deficiency and such amount shall, when the decision of the Board becomes final, be assessed and shall be paid upon notice and demand from the collector.

(c) [as amended by Sec. 9 of the Excess Profits Tax Amendments of 1941] *Finality of determination.*—If in the determination of the tax liability under this subchapter the determination of any question is necessary solely by reason of section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722, the determination of such question

[1] By Section 203 (a) of an Act of December 29, 1945, c. 652, 59 Stat. 673, the language in the parentheses was changed so as to read "(not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the ninetieth day)," and by Section 203 (b) of that Act the change was made effective as of September 8, 1945.

shall not be reviewed or redetermined by any court or agency except the Board.[8]

(d) [as added by Sec. 222 (c) of the Revenue Act of 1942] *Review by special division of Board.*—The determinations and redeterminations by any division of the Board involving any question arising under section 721 (a) (2) (C) or section 722 shall be reviewed by a special division of the Board which shall be constituted by the Chairman and consist of not less than three members of the Board.[9] The decisions of such special division shall not be reviewable by the Board, and shall be deemed decisions of the Board. (26 U. S. C. 1940 ed., Sec. 732.)

Treasury Regulations 109, promulgated under the Internal Revenue Code, as amended by T. D. 5045, 1941–1 Cum. Bull. 69:

SEC. 30.721–1. *Abnormalities in income in taxable year.*—Section 721 provides relief where abnormal income (as defined in section 721 (a)) for any excess profits tax taxable year is attributable to other taxable years. The term "abnormal income" means income of any class includible in the gross income of the taxpayer for any ex-

[8] By Section 17 of the Excess Profits Tax Amendments of 1941, the amendments made by that Act of Section 732 (a), (b) and (c) were made effective as of the date of the enactment of the Excess Profits Tax Act of 1940.

[9] By Section 2 of the Act of June 30, 1945, c. 211, 59 Stat. 295, Section 732 (d) was amended so as to add the words "with respect to any taxable year" after the words "section 722." This change was to correct "a technical error in Section 222 of the Revenue Act of 1942 * * *. The effect of the amendment is that the review provision will apply to all taxable years beginning after December 31, 1939." S. Rep. No. 399, 79th Cong., 1st Sess. (pp. 1–2).

cess profits tax taxable year (A) if it is abnormal for the taxpayer to derive gross income of such class, or (B) if the taxpayer normally derives gross income of such class but the amount of such income of such class is in excess of 125 per cent of the average amount of the gross income of the same class determined for the four previous taxable years or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence. It is abnormal for a taxpayer to derive income of any class only if the taxpayer had no gross income of that class for the four previous taxable years. For the purpose of determining abnormal income under this paragraph the gross income of the class for the previous taxable years is not to be increased or decreased by any allocation under the provisions of section 721. Abnormal income is to be determined by considering classes of income, and not merely particular items. As to the classification of income, see section 30.721–2.

* * * * *

SEC. 30.721–2. *Classification of income.* —Section 721 (a) (2) (A), (B), (C), (D), (E), and (F) sets forth six separate classes of income. Income which does not fall within those provisions may be grouped by the taxpayer, subject to approval by the Commissioner on the examination of the taxpayer's return, in such other classes as are reasonable in a business of the type which the taxpayer conducts, and as are appropriate in the light of the taxpayer's business experience and accounting practice.

* * * * *

SEC. 30.721–3. *Amount attributable to other years.*—The mere fact that an item includible in gross income is of a class abnormal either in kind or in amount does not result in the exclusion of any part of such item from excess profits net income. It is necessary that the item be found attributable under these regulations in whole or in part to other taxable years. Only that portion of the item which is found to be attributable to other years may be excluded from the gross income of the taxpayer for the year for which the excess profits tax is being computed.

Items of net abnormal income are to be attributed to other years in the light of the events in which such items had their origin, and only in such amounts as are reasonable in the light of such events. To the extent that any items of net abnormal income in the taxable year are the result of high prices, low operating costs, or increased physical volume of sales due to increased demand for or decreased competition in the type of product sold by the taxpayer, such items shall not be attributed to other taxable years. Thus, no portion of an item is to be attributed to other years if such item is of a class of income which is in excess of 125 per cent of the average income of the same class for the four previous taxable years solely because of an improvement in business conditions. In attributing items of net abnormal income to other years, particular attention must be paid to changes in those years in the factors which determine the amount of such income, such as changes in prices, amount of production, and demand for the product. No portion of an item of net abnormal in-

come is to be attributed to any previous year solely by reason of an investment by the taxpayer in assets, tangible or intangible, employed in or contributing to the production of such income.

* * * * *

SEC. 30.732–1 [as further amended by T. D. 5264, 1943 Cum. Bull. 761]. *Review of abnormalities by the Tax Court of the United States.*—Section 732 provides that, in addition to its jurisdiction to redetermine a deficiency, The Tax Court of the United States shall have jurisdiction to review the Commissioner's disallowance of a claim for refund of excess profits taxes, if such disallowance involves the determination of any question relating solely to the application of section 711 (b) (1) (H), (I), (J), or (K), relating to abnormal deductions during the base period, section 721, relating to abnormalities in income in the taxable period, or section 722, relating to general relief from excessive and discriminatory excess profits taxes. The taxpayer's petition must be filed with The Tax Court within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) after the sending by registered mail of the notice of disallowance of the claim for refund.

Where the taxpayer has filed such a petition the notice of disallowance of its claim for refund is considered to be a notice of deficiency for all purposes relating to the assessment and collection of taxes or the refund or credit of overpayments. If The Tax Court finds that there has been no overpayment of tax with respect to the taxable year involved, and further finds that there is a deficiency for such year, The Tax

Court will determine the amount of such deficiency and such amount shall, when the decision of the Tax Court becomes final, be assessed and paid upon notice and demand from the collector.

The extent and the finality of The Tax Court's jurisdiction with respect to questions involving the sections dealing with abnormalities and general excess profits tax relief are set forth in section 732 (c) and (d). If the ascertainment of the excess profits tax liability for a taxable year is dependent in whole or in part upon the determination of any question which is necessary solely by reason of section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722, the determination of such question shall not be reviewed or redetermined by any court or agency except The Tax Court. If the determinations and redeterminations by any division of The Tax Court involve any question arising under section 721 (a) (2) (C) or section 722, such determinations and redeterminations shall be reviewed by a special division of The Tax Court which shall be constituted by the presiding judge and shall consist of not less than three judges of The Tax Court. The decisions of such special division shall not be reviewable by The Tax Court, or by any court or agency, and shall be deemed decisions of The Tax Court. The application of section 732 (c) and (d) may be shown by the following example:

Example.—A taxpayer, which is a domestic manufacturing corporation, has filed a claim for refund for a taxable year beginning in 1942, and as a result of the Commissioner's action with respect to such claim, makes the following contentions:

first, that it is entitled to a constructive average base period net income of $1,300,000 pursuant to an application filed on Form 991 for relief under section 722 instead of a constructive average base period net income of $900,000 determined by the Commissioner; second, that $100,000 of income from a judgment based upon a claim for patent infringement is net abnormal income attributable under section 721 to prior years whereas the Commissioner has attributed only $60,000 to such years; and third, that the amount of gross income determined by the Commissioner is too large. Since the taxpayer's first contention is predicated upon an issue arising under section 722, the Commissioner's determination is reviewable only by The Tax Court, and any determination or redetermination made by any division of The Tax Court must be reviewed by the special division constituted by the presiding judge; the decision of such special division is the decision of The Tax Court and cannot be reviewed by The Tax Court or any court or agency. The taxpayer's second contention is based upon an issue arising under section 721; therefore the Commissioner's determination is reviewable only by The Tax Court. Since the issue arises under section 721 (a) (2) (A), and not section 721 (a) (2) (C), no further review is required by the special division, and the decision of The Tax Court is final and cannot be reviewed by any court or agency. The taxpayer's third contention does not arise under either section 711 (b) (1) (H), (I), (J), or (K), section 721, or section 722, but independently of such sections. Consequently review of this issue is not confined to The Tax Court.

Treasury Regulations 103, promulgated under the Internal Revenue Code as amended:

SEC. 19.22 (b) (2) (A)–3 [as added by T. D. 5194, 1942–2 Cum. Bull. 53, and as amended by T. D. 5271, 1943 Cum. Bull. 92]. *Transfers of life insurance, endowment, or annuity contracts.*—In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, to which section 22 (b) (1) or (2) (A) applies, only the actual value of the consideration given for such transfer and the amount of the premiums and other sums subsequently paid by the transferee shall be excluded from gross income, in lieu of the amounts provided in section 19.22 (b) (1)–1, section 19.22 (b) (2) (A)–1, or section 19.22 (b) (2) (A)–2, to be excluded with respect to payments under such life insurance, endowment, or annuity contract. In the event of such a transfer (other than to the insured, the rule stated in the preceding sentence transforms the exemption applicable under section 22 (b) (1) or (2) (A) from that determined as in the case of the insured or person to whom the policy was originally issued to an exemption determined as in the case of a transferee for a valuable consideration. The exemption applicable in the case of a transferee without valuable consideration or a donee beneficiary is determined in accordance with the rule applicable in the case of its last transferor or last owner of the policy. For the purpose of determining gross income for any taxable year beginning after December 31, 1940, in the case of a transfer of a life insurance, endowment, or annuity contract or any interest

therein, if such contract or interest therein has a basis for determining gain or loss in the hands of the transferee determined, in whole or in part, by reference to such basis of such contract or interest therein in the hands of the transferor, the rule stated in the first sentence of this section shall not apply as to such transfer, and the rule applicable under section 22 (b) (1) or (2) (A) to a transferee without valuable consideration (as stated in the preceding sentence) shall apply as if the transfer from such transferor to such transferee were without valuable consideration. Thus, where a corporation acquires a life insurance policy from a predecessor corporation in a tax-free reorganization, if the proceeds received under the policy by reason of the death of the insured would be exempt from taxation in the hands of the transferor, such proceeds received by reason of the death of the insured will be exempt from taxation in the hands of the transferee for a taxable year beginning after December 31, 1940, because the basis is determined with reference to the basis in the hands of the transferor.

The following examples illustrate the application of the provisions of this section:

Example (1)—The A Corporation procures, for a single premium of $500, an insurance policy in the face amount of $1,000 upon the life of X, one of its officers, naming the A Corporation as beneficiary. If X dies during the time the policy is held by the corporation, the proceeds of the policy paid by reason of the death of X will be tax-free to the corporation. If the A Corporation transfers the policy to the B Corporation for a valuable consideration (for example, $600 in cash, and not pursuant to a tax-free exchange or re-

organization), the proceeds paid to the B Corporation by reason of the death of X would be taxable to the extent of $400 ($1,000 minus $600). Similarly, if before the death of X, the B Corporation had transferred the policy to the C Corporation in a tax-free reorganization, the proceeds in the hands of the C Corporation for taxable years beginning after December 31, 1940, would be taxable to the extent of $400, since $600, the consideration paid by Corporation B for the transfer, would be exempt.

Example (*2*).—In 1922, Y took out an annual premium 20-year endowment policy having a maturity value of $20,000. After payment of premiums totaling $5,500, Y assigned the policy to the M Corporation for a consideration of $4,000. If the M Corporation held the policy and paid the premiums thereon, the $20,000 received upon maturity of the policy (while A is still alive) would be includible in the income of the M Corporation, except to the extent of the $4,000 consideration paid by it and the premiums which it paid after the transfer. If prior to the maturity of the policy, the M Corporation transferred its assets, including the policy, to the N Corporation in a tax-free exchange for the stock of the N Corporation and the N Corporation held the policy until maturity (1942), paying all premiums due thereon after such transfer, the $20,000 received by the N Corporation would be includible in its gross income, except to the extent of the $4,000 consideration paid by the M Corporation for the transfer of the policy from Y and the aggregate premiums paid by the M and N Corporations upon the policy.

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